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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 72

STATE OF WISCONSIN and PUBLIC SERVICE COMMISSION OF WISCONSIN, and PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, *Petitioners*,

v.

FEDERAL POWER COMMISSION and PHILLIPS PETROLEUM COMPANY, *Respondents*.

No. 73

PEOPLE OF THE STATE OF CALIFORNIA and PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *Petitioners*,

v.

FEDERAL POWER COMMISSION and PHILLIPS PETROLEUM COMPANY, *Respondents*.

No. 74

LONG ISLAND LIGHTING COMPANY, PHILADELPHIA ELECTRIC COMPANY, and THE UNITED GAS IMPROVEMENT COMPANY, *Petitioners*,

v.

FEDERAL POWER COMMISSION and PHILLIPS PETROLEUM COMPANY, *Respondents*.

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR RESPONDENT PHILLIPS PETROLEUM COMPANY

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On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR RESPONDENT PHILLIPS PETROLEUM COMPANY

OPINIONS BELOW

The opinion of the Court of Appeals (R. 410-430) is reported at 303 F. 2d 380. The opinion and the order of the Federal Power Commission (R. 251-342) is

reported at 24 FPC 537, and the Commission's order denying rehearing (R. 395-404) is reported at 24 FPC 1008. The decision of the Presiding Examiner (reproduced in part in the record, R. 35-217) is reported in full at 24 FPC 590.

JURISDICTION

The jurisdictional requisites are adequately set forth in Petitioners' briefs.

STATUTE INVOLVED

The statute involved is the Natural Gas Act (52 Stat. 821-833, as amended; Title 15 USC §§ 717-717w). The pertinent provisions are printed in Petitioners' briefs in No. 72 (pp. 2-5) and No. 74 (pp. 2-5). Additional provisions of the Natural Gas Act are printed in the Appendix to Petitioner's brief in No. 73.

QUESTIONS PRESENTED

The principal question presented is:

1. May the Federal Power Commission terminate its investigation of the rates of an independent producer under Sections 4(e) and 5(a) of the Natural Gas Act after reviewing the record and finding that (1) test year cost of service substantially exceeded test year revenues (even after allowing for Section 4(e) increases), (2) there is nothing to show that existing rates are unduly discriminatory or preferential, and (3) at the time of decision in 1960, the 1954 test year is not suitable for fixing future rates?

An additional question which is presented only in No. 73 is:

2. May the Federal Power Commission refuse to reject a rate increase based on contractual provisions

which (after a specified increase in the wholesale commodity index) permit a producer to increase its price in proportion to an increase in the resale rates of the pipeline company purchaser, particularly where the Commission considered such provision as constituting nothing more than contractual consent to a rate increase which must be otherwise justified?

STATEMENT

A. The Proceedings Before the Commission

On November 22, 1954, following the decision of this Court in *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672 (1954), the Federal Power Commission (Commission) reinstituted its investigation (which had been initiated originally by the Commission's order of October 28, 1948, R. 17) into the rates and charges of Phillips Petroleum Company (Phillips) pursuant to Section 5(a) of the Natural Gas Act (Act). The purpose of the investigation was to determine whether any of Phillips' existing rates were unjust or unreasonable and, if so, to fix just and reasonable rates for the future.[1] This general investigation was docketed under the style "In the Matter of Phillips Petroleum Company, Docket No. G-1148".

On August 6, 1954, the Commission issued its order No. 174 which, together with subsequent orders, established rules and regulations under which independent producers of natural gas (as defined in such orders) were required to file rate schedules and certificate ap-

[1] Both the order issued October 28, 1948, (R. 20), the original order establishing the Section 5(a) proceeding and the order issued November 22, 1954, reopening the Section 5(a) investigation (R. 409) specifically provided for the fixing of rates only in the event existing rates were found to be unjust or unreasonable.

plications (18 CFR Secs. 154.91-154.103, 157.23-157.31). Pursuant to these regulations Phillips filed rate schedules and certificate applications covering its sales being made subject to the jurisdiction of the Commission. From time to time thereafter, Phillips also filed, pursuant to Section 4 of the Act and the Commission's regulations thereunder, changes in rates to permit it to collect increases provided in its contracts.

On May 28, 1956, the Commission issued its order providing for the commencement on June 26, 1956, of *hearings in* the general investigation (Docket No. G-1148). In the same order, the Commission consolidated eight rate increase proceedings designated as Docket Nos. G-3175, G-4333, G-6621, G-7773, G-8623, G-8695, G-8883 and G-10359, all of which covered rate increases which had been filed by Phillips and suspended by the Commission pursuant to Section 4(e) of the Act (R. 21). Subsequent to the commencement of hearings, the Commission consolidated with Docket No. G-1148 four additional Section 4(e) rate increases designated as Docket Nos. G-10793, G-10883, G-11125, and G-11217 (R. 27). The consolidated proceedings as so constituted included all but two of the rate increases which had been filed by Phillips and suspended by the Commission prior to December 14, 1956, the date of the order of consolidation.[2]

During the course of the hearings in Docket G-1148 and the consolidated Section 4(e) increases and thereafter, Phillips continued to file from time to time fur-

[2] The only two rate increases not consolidated were those involved in Docket Nos. G-11309 and G-11326. The two increases combined totaled less than $10,000 annually. Both increases were later settled and the proceedings terminated prior to the issuance of the Commission's opinion in this proceeding.

ther increases pursuant to Section 4 of the Act. Many of these increases were suspended by the Commission pursuant to Section 4(e) of the Act. The Commission did not act to consolidate any of these later Section 4(e) increases with these proceedings and no party requested that such later increases be made a part of this proceeding. All parties appeared content to allow the later Section 4(e) increases to be considered in future proceedings. Consequently, the record in this proceeding does not include any evidence with respect to revenues resulting from or costs related to such later increases. Except in one minor case (Docket G-8623) involving an annual increase of $21,234 (R. 325), all of these consolidated Section 4(e) increases had at the time of the Commission's decision in this proceeding been superseded by one or more of the other rate increase filings mentioned above and which had been suspended and are still pending before the Commission in other dockets.[3]

Hearings on the consolidated Section 4(e) and Section 5(a) proceedings commenced as ordered on June 26, 1956, and terminated on December 18, 1957. Phillips, the Commission Staff and thirty-one Intervenors actively participated in the hearings (R. 252). Following the close of hearings, the Presiding Examiner issued a lengthy decision (reproduced in part, R. 35-217, reported in full, 24 FPC 590). Numerous exceptions to his decision were then filed with the Commission. On September 28, 1960, the Commission issued a comprehensive opinion reviewing and passing upon the issues presented and allowing and disallowing exceptions to the Examiner's decision (R. 251-342). On

[3] The increase in Docket No. G-8623 has since been superseded by a later filing (not suspended by the Commission).

November 25, 1960, the Commission issued its order passing upon applications for rehearing filed by various Intervenors, amending in part its previous opinion and order and otherwise denying the applications for rehearing (R. 395-404).

B. The Opinion of the Commission

The record before the Commission dealt solely with the rates of Phillips. Nevertheless, the opinion of the Commission in part dealt with matters unrelated to this particular record and involving the general philosophy of principles to be followed in the regulation of independent producers. With respect to such other matters, the Commission first considered at some length the problems which it faced in the regulation of independent producers (R. 256-269). The Commission approached this discussion with the observation:

> "Experience of the Commission in this case, as well as in many other producer rate cases during the last five years, has shown, beyond any doubt, that the traditional original cost, prudent investment rate base method of regulating utilities is not a sensible, or even a workable method of fixing the rates of independent producers of natural gas. The fact that, in this case, we can, by making numerous arbitrary allocations and estimates, arrive at a calculated unit cost of gas does not prove to anyone's satisfaction, including ours, that we have thus solved the problem of fixing prices for natural gas sold by independent producers. We recognize that the use of this method for regulating utilities provides only some possible aid toward solving, but not the answer to, the problem of fixing producers' rates." (R. 256-257)

After reviewing the various problems and difficulties involved, the Commission determined that " . . . the

better method would be to establish fair prices for the gas itself and not for each individual producer". The Commission then announced that it was inaugurating a different method of regulating independent producers to be employed in future proceedings and that, simultaneously with but separate and apart from this proceeding, it was "promulgating a policy statement setting forth rate guidance levels for various producing areas of the country" (R. 266). This separate policy statement was issued by a separate document (not docketed as a part of this proceeding) designated as Statement of General Policy No. 61-1 (R. 343).

The Commission recognized that neither area rates nor the guideline rates announced in the Statement of General Policy were available as a basis for decision in this case. *The Statement of General Policy, as such, is not an issue here, since the record dealt only with Phillips' revenues, costs and rates and there is no evidence relating to that Statement.* On the basis of the record made, the Commission therefore undertook to decide this proceeding by determining a cost of service for Phillips and comparing that cost of service with contract revenues (R. 269-272). By far the greater portion of the Commission's opinion dealt solely with Phillips, was based upon evidence which applied only to Phillips, and in substance constituted an application by the Commission to Phillips' rates of cost principles of the kind referred to in *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810 (D.C. Cir. 1956), cert. denied 352 U.S. 829.

The determination of a cost of service for Phillips necessarily required the Commission to resolve many different subsidiary questions, such as the method to be used for allocation of exploration costs between gas

and oil (R. 269-306).[4] None of those subsidiary questions are at issue here. In making its determination the Commission approved and adopted the Examiner's finding that the calendar year 1954, with adjustments for certain known increases in costs and increases in revenues through 1956, constituted a proper test year (R. 272). A "test year", as used by the Commission, "involves the use of the statistics of an actual period of twelve months with an estimate of expected sales and expenses for some months into the future. It is sought by this method to develop a statement of costs and revenues for a normal year from which a just and reasonable rate may be derived for future periods." *Michigan Wisconsin Pipe Line Co.* v. *Federal Power Commission*, 263 F. 2d 553, 555 (6th Cir. 1959). *None of the parties objected to 1954 as the test year.* Some parties objected to some of the adjustments and some parties sought trial calculations for additional years, but the use of 1954 cost data for test year purposes was accepted by all parties. Acting on the basis of this test year, the Commission determined that Phillips' cost of service was $55,548,054 (R. 322), modified on rehearing to $54,525,315 (R. 401),[5] compared to test

[4] We do not here intend to indicate our agreement with the cost of service as determined by the Commission. From the viewpoint of Phillips, the cost of service as determined by the Commission is far too low, as the result of numerous errors which we believe were made by the Examiner and the Commission. Because the Commission has not attempted to formulate rates based on that cost of service, there has not yet been any occasion for Phillips to raise any issue with respect to the amount of the cost of service. For the purposes of this proceeding, it is sufficient that the cost of service is at least as high as that determined by the Commission.

[5] Neither of the amounts stated include the additional royalties, taxes and purchase costs which the Commission found would result if Phillips' rates were increased to produce revenues equal to its

year jurisdictional revenues of $45,568,291 (R. 326). The test year revenues as stated included the consolidated Section 4(e) increases, thus leaving a deficiency of approximately $9,000,000 annually between cost of service and contract revenues (R. 212).

The determination of a cost of service was of course merely a step, albeit a major one, in the decisional process. As stated by the Commission:

> "The present proceeding involves an investigation of Phillips' rates on the basis of a record including evidence on the alternate test years 1954 and 1956 of which we chose 1954 in accordance with the decision of the examiner. From our knowledge of the industry, it is clear enough that costs and prices of gas in the field have greatly increased since that time. For instance, we have suspended approximately 95 rate changes filed by Phillips subsequent to the hearing in these proceedings. Some of its more recent filings involve substantial increases. Therefore we do not deem it appropriate to prescribe or require that Phillips file rates for the future based upon the present record. In fact, if this order provided for rates for the future effective in 1960 but based on the test year 1954, it might easily occur that the rates approved here would be lower than those approved in some of Phillips' suspension proceedings now before us. The consequence of this would be that Phillips would be required to decrease its rates in 1960 based upon an earlier test year, a result without reason or justice.
>
> "As a result we shall terminate the rate investigation proceedings in Docket No. G-1148 under

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cost of service (R. 322, Footnote 41). The Commission held that these added costs would properly be a part of Phillips' cost of service. Addition of such costs would raise the average cost of service from 11.1009¢ per Mcf to approximately 12.16¢ per Mcf.

Section 5(a). Phillips' customers will not be substantially injured, for Phillips' rate filings have been subject to our continuing surveillance and many large increases filed by it have been suspended under Section 4(e) of the Act and are currently the subject of proceedings before us. Furthermore, there is nothing to show that Phillips' contracts relating to Phillips' diverse conditions of sale are unduly discriminatory or preferential. Additionally its customers and consumers will receive the protection of our area pricing standards announced at this time. Phillips will not be injured, for we are thus leaving in effect its contract structure; it has had the privilege of filing increased rates and has done so in substantial amounts as already noted.

"Our approach must be similar with respect to the twelve Section 4(e) proceedings consolidated herewith. Except in one minor case all of these proceedings involve rates which have become effective after the test year, but have been superseded by other rates suspended by us in other proceedings. They must be considered in the light of the record in this case which is based on the cost of service method of regulation, but our conclusions here should not bind future determinations of Phillips' rates either in Section 4(e) proceedings or rate investigations under Section 5(a). The record in this proceeding indicates that these rates have produced revenues less than Phillips' cost of service during the periods that they were in effect. The cost of service determined by us of $55,548,054 or 11.309 cents per Mcf is substantially in excess of Phillips' applicable jurisdictional revenues of $45,568,291.

"Although there is considerable diversity among the rates, there is nothing in the record to show that these past rates reflecting the different conditions of sale are unduly discriminatory or preferential. To allocate costs to each of them would

require reopening the proceedings and the introduction of elaborate evidence. Little would be accomplished by way of adjusting them in any case since neither Phillips nor this Commission have authority under the Act to increase any of them retroactively above the filed level. On our part we would like to disturb area rate patterns as little as possible, particularly on a retroactive basis, having in mind the involved business arrangements that have arisen between the producers and their customers as the industry has developed. We thus find no purpose in continuing the Section 4(e) proceedings and will order that they be terminated with two exceptions discussed below." (R. 324-326) (Footnotes omitted)

Applications for rehearing were filed by some of the parties. In their applications none of these parties objected to the Commission's findings that cost of service exceeded revenues and that Phillips' rates are not unduly discriminatory or preferential. These parties did complain of the dismissal of the proceedings without fixing rates and some requested that the proceedings be reopened. In its "Order Denying Applications for Rehearing, Amending Opinion and Rejecting Application for Rehearing" (R. 395-404), the Commission restated its reasons for terminating the proceedings:

"As we stated in our opinion, on the basis of the record and the test year 1954, we cannot reach a decision on cost of service applicable to the years after the issuance of our opinion and order. The Eastern Seaboard Companies argue that we should grant rehearing, consolidate all of Phillips' Section 4(e) proceedings and direct Phillips to submit a 1959 cost of service determination based on Opinion No. 338 as well as revised rate schedules designed to return its current costs. This, of course, would require reopening the record and

the submission of completely new evidence. For the future it is our judgment that the interest of consumers and the exigencies of regulation will be better served in rate proceedings brought on an area basis rather than on an individual company basis. Therefore, we do not think it in the public interest to reopen these proceedings, to determine a cost of service on the basis of completely new evidence to attempt to determine rates on the basis of Phillips' individual cost of service.

"The basis of our decision to terminate the dozen Section 4(e) dockets was that the rates filed in those dockets produced less revenues than the cost of service determined in our opinion. The fact that some of these rates are in excess of the average cost of service determined by us is immaterial. Phillips' rates would normally vary greatly because the sales are made at widely separated points and under different conditions, and there is nothing to show that these rates are discriminatory or preferential. In our judgment there is little or nothing to be gained for the consumer by continuing a complicated proceeding so as to determine just and reasonable rates for Phillips when it is already known that Phillips was not earning its whole cost of service. To conclude, the attempt here to regulate Phillips' rates on an individual company basis has proved cumbersome and inexact. It has demonstrated however, that there is no public interest in continuing the Section 4(e) proceedings, which are largely concerned with past periods. Furthermore, because of the lapse of time, the 1954 cost of service determined by us is not appropriate for the future. The more recent rate increases filed with us have been suspended under Section 4(e), and they will be subject to the new area methods of regulation discussed in our Policy Statement. In this way we can proceed to a more effective and expeditious regulation of the producer sales." (R. 396-398)

C. The Decision of the Court of Appeals

Petitions for review of the Commission's opinion and order were filed in the United States Court of Appeals for the District of Columbia Circuit by the State of Wisconsin and Public Service Commission of Wisconsin (Wisconsin), the State of California (California) and by Long Island Lighting Company, Philadelphia Electric Company and The United Gas Improvement Company (the Eastern Seaboard Companies). The Public Service Commission of the State of New York (New York) did not file a petition for review but was permitted to intervene in the proceedings in the Court of Appeals.

With respect to the Section 4(e) increases, the Court held that the Commission's findings that cost exceeded revenue, and that the rates were not unduly discriminatory or preferential, justified the termination of those proceedings. The Court specifically held that under the circumstances the Commission was not required to make intermediate (and in effect pointless) findings as to whether the individual 4(e) rates were just and reasonable during the period they were in effect (R. 418-421). The Court also sustained the Commission's termination of the Section 5(a) investigation upon the basis of the record before it. The Court also held that the Commission, being unable to fix rates for the future on the basis of this record, was authorized in its discretion to initiate area proceedings as a basis for fixing rates for the future.

After so holding, the Court then discussed the interim rate procedure set forth in the Commission's Statement of General Policy No. 61-1 pending the fixing of future rates in an area rate proceeding. With respect to this latter point, in approving the Commission's right to establish such a policy, the Court made

it plain that the rates set forth therein were merely guideline rates and were not necessarily just and reasonable rates, as was made plain by the Commission when it stated in its Statement of General Policy as follows (R. 416):

> " 'These price levels, as announced by Appendix A attached to this statement, are for the purpose of guidance and initial action by the Commission and their use will not deprive any party of substantive rights or fix the ultimate justness and reasonableness of any rate level.' "

and as stated by the Commission in its Opinion No. 338 with respect to the rates set forth in its Statement of General Policy No. 61-1 (R. 266):

> "This schedule of prices is only for guidance and does not constitute any determination of just and reasonable rates and will not foreclose any person from justifying a particular rate in any area."

With one judge dissenting, the Court affirmed the Commission.

SUMMARY OF ARGUMENT

I.

Petitioners in Nos. 72 and 73 now seek to raise issues which were not raised in their Application for Rehearing to the Commission. This Court is without jurisdiction to consider any objection to the order of the Commission unless such objection was urged before the Commission in the application for rehearing or there is reasonable ground for failure to do so. *Federal Power Commission* v. *Colorado Interstate Gas Co.*, 348 U.S. 492 (1945). Wisconsin and New York, Petitioners in No. 72, now contend that it was error for

the Commission to terminate the Section 5(a) proceedings and contend also that the Section 4(e) rate increases were discriminatory on their face. Neither contention was made in the application for rehearing and no excuse is offered or available for failure to do so. California, Petitioner in No. 73, now contends that the Commission has erred by abandoning cost of service as a basis of regulation and instead relying on the schedule of prices set forth in the Commission's Statement of General Policy No. 61-1. California not only did not raise these issues in its application for rehearing but instead specifically advised the Commission that it would not raise such issues in this proceeding.

In addition, Petitioners in No. 72 have completely disregarded an explicit rule of this Court. In their petition for certiorari, these Petitioners stated only one Question Presented. In their brief, these Petitioners have added a second Question, dealing with the alleged discriminatory nature of the Section 4(e) increases. Paragraph 1(d)(2) of Rule 40 of this Court expressly prohibits the raising of questions in the brief which were not raised in the petition.

II.

The Commission did not err in terminating the Section 5(a) proceedings without fixing rates for the future. Under the findings made by the Commission, the Commission's only alternatives were either to terminate the proceedings or to reopen the proceedings for the reception of "completely new evidence". Petitioners do not object to the Commission's decision not to take action on this record; Petitioners object only to the Commission's decision to receive additional evidence in a different proceeding instead of reopening this record.

Petitioners seek administrative relief rather than judicial review. What Petitioners demand is that this Court act as a super-administrative body and direct the Commission in the conduct of its administrative functions. Petitioners are not entitled to judicial review because they have shown no injury on this record. One of the main targets of Petitioners' objections—Statement of General Policy No. 61-1 and accompanying price schedules—was not used in any way to support the findings of the Commission, since the Commission's findings were based solely on Phillips' costs and revenues as shown in this record. The statutory power "to affirm, modify, or set aside" orders of the Federal Power Commission does not authorize the Court "to exercise an essentially administrative function", *Federal Power Commission* v. *Idaho Power Co.*, 344 U.S. 17, 21 (1952). Administrative bodies are and must be allowed to control their own affairs free of court interference. *Federal Communications Commission* v. *Pottsville Broadcasting Company*, 309 U.S. 134 (1940).

Since the Commission did not find Phillips' rates to be "unjust, unreasonable, unduly discriminatory or preferential", the Commission was not authorized to fix rates for the future in this proceeding. Under Section 5(a) of the Act, such a finding is a condition precedent to the authority of the Commission to fix rates for the future. *Federal Power Commission* v. *Sierra Pacific Power Company*, 350 U.S. 348, 353 (1956). After a careful review of the entire record, the Commission did not make such findings. Except for the unsupported contention—made here for the first time—that some of the contract rates are discriminatory, Petitioners do not contend that the Commission should have done so. It was therefore entirely proper

for the Commission to terminate the Section 5(a) proceedings without fixing rates for the future.

The contention that the Commission erred in permitting the contract rates to stand, without finding such rates to be just and reasonable, is wholly without substance. This Court in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) made it clear that the power and authority of the Commission over rates is simply the power to review rates and contracts, made in the first instance by natural gas companies, and to set aside and modify only those rates or contracts which it finds after hearing, to be unjust, unreasonable, unduly discriminatory or preferential. Any rate or contract which the Commission after hearing does not find to be unlawful stands on its own feet and is not dependent upon any finding by the Commission that it is just and reasonable. The Act does not require any such affirmative finding and no court has so interpreted the Act. On the contrary, this Court's decision in *Federal Power Commission v. Sierra Pacific Power Company*, 350 U.S. 348 (1956) shows that the Commission may be compelled to allow a contract rate to remain in force even though the Commission does not and could not find such rate to be just and reasonable.

The decision not to reopen this proceeding lay solely within the discretion of the Commission. The Commission found that the present record was not representative of future conditions. Petitioners do not contend that the Commission should have acted on this record. The question of whether a proceeding such as this should be reopened is a matter for the discretion of the Commission, not a matter of law for this Court. *Interstate Commerce Commission v. Jersey City*, 322

U.S. 503, 514-515 (1944); *United States* v. *Pierce Auto Freight Lines*, 327 U.S. 515, 535 (1946); *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810, 822 (D.C. Cir. 1955), cert. denied 352 U.S. 829. Since the Commission found that any reopening would require "completely new evidence" (R. 397), it clearly was not an abuse of discretion to decide to receive such new evidence in a new proceeding.

III.

The Commission was fully justified in terminating the consolidated Section 4(e) proceedings. The specific bases for terminating such proceedings were the Commission's findings that such rates had not produced revenues in excess of the cost of service and that the evidence did not show that such rates were unduly discriminatory or preferential (R. 325-326, 397). Petitioners do not contend that the evidence would entitle them to refund of any of the revenues collected under the consolidated Section 4(e) rate increases. Furthermore, revenues above the levels of the consolidated Section 4(e) increases which result from later increases are not affected by the termination of the consolidated Section 4(e) proceedings, since these later increases remain subject to pending Section 4(e) proceedings. The Commission's findings are supported by substantial evidence and are therefore binding on the Court. Natural Gas Act, Section 19(b). Further refinements of these findings would serve no useful purpose.

IV.

The Commission properly refused to reject contractual price increases based on so-called "spiral escalation clauses". These contract provisions were not treated by the Commission as automatically en-

titling Phillips to an increase but only as furnishing the contractual consent to an increase. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.* 350 U.S. 332 (1956). The increases based on these contractual provisions were allowed because the revenues produced by contract rates were less than the cost of service. Contract provisions permitting price escalations at indefinite times are clearly valid and enforceable. *Texas Gas Transmission Corporation* v. *Shell Oil Company*, 363 U.S. 263 (1960); *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, 391 (1959); *Warren Petroleum Corp.* v. *Federal Power Commission*, 282 F. 2d 812 (10th Cir. 1960). These particular contract provisions have themselves been upheld and enforced. *Phillips Petroleum Co.* v. *Federal Power Commission*, 227 F. 2d 470 (10th Cir. 1955), cert. denied sub nom. *Michigan Wisconsin Pipe Line Co.* v. *Phillips Petroleum Co.*, 350 U.S. 1005; *Kerr-McGee Oil Industries, Inc.* v. *Federal Power Commission*, 260 F. 2d 602 (10th Cir. 1958). Here the Commission has acted in accord with Congressional policies and has reviewed these increases on the basis of methods which California espouses and upon findings which California does not challenge.

ARGUMENT

I.

PETITIONERS' BRIEFS IN NOS. 72 AND 73 ATTEMPT TO RAISE ISSUES NOT PROPERLY BEFORE THE COURT

Section 19(b) of the Act (17 USC § 717r(b)) provides:

> "No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do."

In No. 72, Wisconsin and New York not only seek to raise questions not urged in the application for rehearing but, in flagrant violation of the express provisions of Rule 40(1)(d)(2) of this Court, also seek to raise an additional question not presented in the Petition for Certiorari. In No. 73, California now urges as reversible error issues which it specifically told the Commission in its application for rehearing it would not raise. Petitioners do not suggest any reason for having failed to raise these objections in their applications for rehearing, and none is available.

No. 72

Petitioners in No. 72 attempt to present two separate questions (Br. No. 72, p. 5). While stated in terms of whether the Commission may "indefinitely defer" the fixing of rates, the first question which these Petitioners seek to present is whether the Commission properly terminated its investigation of Phillips' rates under Section 5(a) of the Act. Their argument on this point leaves no doubt that it is the Commission's action under Section 5 which they desire to have reviewed (Br. No. 72, pp. 21-43). But the termination of the Section 5(a) investigation was not raised by Wisconsin in its application for rehearing to the Commission, the only application for rehearing which supports the proceedings in No. 72.

New York is in the unusual position of having sought and obtained a review by this Court of the Commission's order without having first met the statutory requirement of a timely application for rehearing to the Commission. New York's application for rehearing was tendered after the expiration of the statutory period and was therefore ineffective to preserve its

right to review (R. 395). Upon its application, however, the Court of Appeals permitted New York to intervene in the proceedings below. Its status as a party in the court below thereby gave New York standing to petition for certiorari. 28 USC § 1254(1); *International Union* v. *Eagle-Picher Co.*, 325 U.S. 335, 338-9 (1945).

But mere standing to petition does not determine the issues which may be reviewed. This Court has specifically held that the matters set forth in the application for rehearing limit not only the parties but the reviewing court as well. *Federal Power Commission* v. *Colorado Interstate Gas Co.*, 348 U.S. 492 (1955). Since New York filed no timely application for rehearing, it must confine itself to those issues raised by its co-petitioner, Wisconsin. Wisconsin elected not to include in its application for rehearing those issues which New York has now prevailed upon Wisconsin to assert.

The Wisconsin application for rehearing is the most detailed of those filed by the various Petitioners (R. 349-362). Even so, it did not object to the termination of the Section 5(a) investigation. Its Point (1) urged the striking of the Commission's "statements as to policies to be followed in regulating the rates of independent producers" (R. 351). Its Points (2) through (11) all related to contentions now abandoned (R. 353-360). Finally, its Point (12) alleged error in the termination of part of the consolidated Section 4(e) proceedings (R. 360). But nowhere in that application is there assertion of error in the Commission's termination of the Section 5(a) proceedings. Nor can such assertion be inferred from the other specifications of error. This Court has held that the application for

rehearing must be sufficiently specific to put the Commission on notice that a particular action of the Commission is being attacked. *Federal Power Commission* v. *Colorado Interstate Gas Co., supra*, 348 U.S. at 498. Absent such notice, the right to review is not preserved.

The second question which Wisconsin and New York now seek to raise relates to the alleged error of the Commission in terminating the Section 4(e) dockets. These Petitioners now assert that the Section 4(e) increases were "discriminatory on their face" (Br. No. 72, p. 5). As noted above, in its application for rehearing Wisconsin objected to the termination of some, but not all, of the Section 4(e) proceedings. At that time Wisconsin complained only that some of the Section 4(e) increases were allowed at levels which exceeded the average cost of service (R. 360-361). Wisconsin was apparently content to leave standing all those Section 4(e) increases in which the increased rate was below the cents per Mcf level stated by the Commission as the "average" cost of service.[6] The contention that the contract rates are discriminatory, which now forms an important part of Petitioners' arguments in No. 72 (Br. pp. 38-43, 45-46), is completely absent. Petitioners' cannot supply this deficiency by merely pointing (Br. No. 72, pp. 40, 45) to assertions that some of the rates exceeded the average cost of service.

[6] Wisconsin's contention that rates should not be allowed above that level was specifically answered by the Commission in its order denying rehearing: "The fact that some of these rates are in excess of the average cost of service determined by us is immaterial. Phillips' rates would normally vary greatly because the sales are made at widely separated points and under different conditions, and there is nothing to show that the rates are discriminatory or preferential." (R. 397)

Aside from statutory requirements, Petitioners' attempt to raise their second question constitutes a complete disregard of an express rule of this Court. The Petition for Certiorari in No. 72 sets forth only one Question Presented (Petition, p. 2). While differing slightly in language, the question stated in the Petition is substantially the same as the first of the questions stated in Petitioners' brief (p. 5). The second question set forth in the brief is wholly new, appearing not at all in the Petition.

Rule 40 specifies the matters to be included in Petitioners' brief. Paragraph 1(d)(2) of that Rule states:

> "The phrasing of the questions presented need not be identical with that set forth in the jurisdictional statement or the petition for certiorari, *but the brief may not raise additional questions or change the substance of the questions already presented in those documents.* Questions not presented according to this paragraph will be disregarded, save as the court, at its option, may notice a plain error not presented."[7]

No. 73

California sets forth six separate questions in its brief in No. 73 (Br. pp. 2-3). Questions (3) and (4) seek to raise issues relating to the alleged abandonment by the Commission of cost of service as a method of regulation and the use by the Commission of the schedule of prices set forth in its Statement of General Policy No. 61-1. Almost half of California's arguments in its brief are devoted to these two questions (Br. No. 73, pp. 35-55).

[7] Unless otherwise indicated, all emphasis in quotations in this brief is supplied.

With respect to these issues, California is now attempting to raise issues which it not only failed to raise in its application for rehearing but which it assured the Commission it would not raise. In its application for rehearing, California stated:

> "California takes no position at this time regarding the opinions expressed by the Commission in Opinion No. 338 under the title 'Regulation of Natural Gas Producers' Prices' (mimeo., pp. 5-12) wherein the Commission announces its conviction that regulation of such prices under the cost of service method is unworkable and productive of ridiculous results and wherein the Commission announces its intention to regulate producer prices hereafter by use of an area pricing method as is more particularly described in the Commission's Statement of General Policy No. 61-1 issued on the same date as it issued its opinion in the instant proceedings. *Because the Commission employed the traditional cost of service method in reaching its findings and conclusions in the instant proceedings* (mimeo., p. 13) *its comments concerning the future course of producer rate regulation are therefore not material here.* California reserves the right, however, to challenge such comments as are contained in that portion of Opinion No. 338 indicated above as well as the Statement of General Policy No. 61-1 in any *future* proceeding wherein the Commission's views therein expressed may be material to its determination of rates under the Natural Gas Act." (R. 363-364)

It is apparent that all of the issues sought to be raised in No. 72 and the two issues mentioned which California seeks to raise in No. 73 are not properly before this Court.

II.

THE COMMISSION PROPERLY TERMINATED THE SECTION 5(a) PROCEEDINGS WITHOUT FIXING RATES FOR THE FUTURE

A. Petitioners Seek Administrative Rather Than Judicial Review

This proceeding is unique in that relief on this record is not one of the principal objectives of Petitioners. Petitioners do not contend that on this record the Commission either could or should have reduced the general level of Phillips' rates.

The Commission found that on the basis of revenues and costs associated with sales for the test year, Phillips' costs exceeded its revenues (R. 326). It found also that the record before it did not permit it to fix rates for the future by declaring existing rates unjust and unreasonable and fixing future rates on the basis of test year costs (R. 271, 324-325). Petitioners do not challenge either of these findings. Petitioners therefore find little purpose in resting upon the record in this proceeding and they do not pretend to confine themselves to it. The great bulk of their arguments are based upon unsupported assertions regarding alleged conditions which, if they exist at all, have occurred either long after the close of this record or in other proceedings. Even when they demand reopening of this proceeding, Petitioners are careful to insist that any reopening must include provision for receipt of additional evidence. None of the Petitioners want further action of the Commission based solely upon this record.

It is thus apparent that what Petitioners seek here is not judicial review but rather a directive from this Court acting as a super-administrative body. Petitioners' concern lies not with what has happened in this

proceeding but with what they desire to happen in future proceedings. Petitioners profess not to attack the concept of area rates; they purport to ask only that the Commission be directed to act in a specific manner until the area rate proceedings have all been completed. Yet it is apparent that, in order to attain their objective, Petitioners must obtain from this Court an administrative directive which lays down for the Commission a pattern of procedure to be rigidly followed, leaving to the Commission some discretion as to the application of court-selected methods but little or no discretion as to choice of methods. Petitioners seem unconcerned by the fact that their own arguments demonstrate that, if the Commission must first apply the Court's concept of regulation, it is doubtful whether the Commission will ever have the time and resources to apply its own.

That Petitioners desire administrative rather than judicial review is forcibly demonstrated by their attacks on the Commission's Statement of General Policy No. 61-1 (R. 343). Substantial parts of Petitioners' briefs are devoted to this attack (No. 72, pp. 29-36; No. 73, pp. 48-55; No. 74, pp. 29-32). Yet Statement of General Policy No. 61-1 and the prices therein stated are not a part of the record in this proceeding. The basis of the Commission's decision to terminate the Phillips proceedings was that the record was not suitable for fixing rates for the future and that Phillips' cost of service exceeded its revenues. The Statement of General Policy rates were not a criterion by which the Commission decided this case. The Commission made no comparison of Phillips' contract rates with those set forth in the Statement of General Policy. Under these circumstances, it can hardly be said that

the Statement of General Policy No. 61-1 is a matter for judicial review on this occasion.

In the context of Petitioners' contentions regarding the proceeding under Section 5(a), judicial review in the traditional sense is impossible here. Petitioners are not entitled to a judgment awarding them some form of monetary relief because they have shown no injury on this record. A mere reversal of the Commission's order would award little or nothing to Petitioners. All that a bare reversal would accomplish would be the preservation of the present docket number. Any reversal must be a hollow victory for Petitioners unless the Court goes further and injects itself deep into administrative affairs by devising and prescribing the Court's own concept of producer regulation.

This Court has held that the statutory power "to affirm, modify, or set aside" orders of the Federal Power Commission does not authorize the Court "to exercise an essentially administrative function". *Federal Power Commission* v. *Idaho Power Co.*, 344 U.S. 17, 21 (1952). It has long been held that administrative agencies are and must be permitted to control their own affairs free of court interference. *Federal Communications Commission* v. *Pottsville Broadcasting Company*, 309 U.S. 134 (1940). The wisdom of the principle that courts and administrative bodies must confine their actions to their own spheres is vividly demonstrated here, where administrative review is all that is sought and judicial review is impossible of accomplishment.

B. The Commission Has Done All That the Natural Gas Act Permitted It to Do on the Basis of This Record

The termination by the Commission of the Section 5(a) investigation was fully in accord with both the language and intent of the Act. Indeed, termination was the only action the Commission could take and the only action authorized by the Commission's findings.

The Commission's power to fix rates under Section 5(a) is conditioned upon a finding that existing rates are unjust or unreasonable. Section 5(a) provides in part:

> "Whenever the Commission, after a hearing had upon its own motion or upon complaint . . . shall find that any rate . . . is *unjust, unreasonable, unduly discriminatory, or preferential*, the Commission shall determine the just and reasonable rate . . . to be thereafter observed and enforced, and shall fix the same by order . . . ."

The Commission's order instituting this investigation followed the language of Section 5(a). That order provided, among other things, that:

> "*If* the Commission shall find, after hearing, that any of Phillips' rates . . . are *unjust, unreasonable, unduly discriminatory or preferential* it shall determine and fix . . . rates . . . to be thereafter observed and enforced" (R. 409).

The critical language in both the statute and the order is the phrase "unjust, unreasonable, unduly discriminatory or preferential". Nothing in the language of the statute or the order requires an express finding that existing rates are just and reasonable. But the negative finding that rates are unjust, unreasonable, unduly discriminatory or preferential is expressly made

a condition precedent to the power of the Commission to fix rates for the future.

This limitation on the Commission's power has been specifically recognized by this Court. In *Federal Power Commission v. Sierra Pacific Power Company*, 350 U.S. 348, 353 (1956), after noting that "the provisions of the Federal Power Act relevant to this question are in all material respects substantially identical to the equivalent provisions of the Natural Gas Act", this Court went on to state:

> "The Commission has undoubted power under § 206(a), to prescribe a change in contract rates whenever it determines such rates to be unlawful. * * *
>
> "The condition precedent to the Commission's exercise of its power under § 206(a) is a finding that the existing rate is 'unjust, unreasonable, unduly discriminatory or preferential'."

Here the Commission did not find Phillips' rates to be unjust or unreasonable. On the basis of its unchallenged finding that costs exceeded revenues, and its finding that contract rates were not unduly discriminatory or preferential, the Commission could have found the existing rates to be unjust or unreasonable only because they were *too low*. Petitioners do not contend that the Commission should have made such a finding. But absent such finding, the statutory condition precedent was not met and the Commission was not authorized to "fix" rates.

Dismissal of the proceedings was therefore the only action which the Commission could take.

C. The Act Does Not Require the Commission to Find Rates to be Just and Reasonable Before Permitting Them to Stand

One of Petitioners' principal contentions is that the Commission erred in permitting existing rates to remain in force without an express finding that such rates were just and reasonable. The Commission's powers under Section 5 are phrased in the negative; before the Commission may act it must find that existing rates are *not* just and reasonable. Neither Section 4 nor Section 5 of the Act requires that existing rates be found to be just and reasonable before they may be permitted to remain in force. On the contrary, the Commission may be obligated to permit rates to remain in effect even though it could not hold such rates to be just and reasonable.

In *Federal Power Commission* v. *Sierra Pacific Power Company*, 350 U.S. 348, 355 (1956), this Court held that, even where contract rates produce less than a fair return, the Commission may not fix different rates unless it can hold the contract rates to be unjust and unreasonable as contrary to the public interest (as distinguished from the private interests of the company). If no such findings can be made, then the contract rates must be left standing. This Court carefully pointed out that the Commission's duty to leave the contract rate in force is not affected by the fact that the Commission could not *impose* so low a rate.

The fundamental principle announced in *Sierra* is that the Commission is not required to determine that a rate is just and reasonable before permitting it to stand. Otherwise, the Commission might be obligated to hold that a rate which produces revenues less than costs is nevertheless just and reasonable. Even if circumstances might be conceived in which such a finding

was permissible, *Sierra* makes it clear that it is not required. In particular, it is not required in circumstances where, as here, no party has suggested that such a finding should have been made.

Petitioners' contention stems from a basic misconception of the purpose and intent of the Act. Petitioners seem to assume that contract rates are unlawful *per se* and that the Act contemplates only rates "fixed" by the Commission. They imply that the Commission has shirked its duty if it merely reviews contract rates and refuses, on the basis of the record before it, to "fix" a different set of rates. The theory of the Act is exactly opposite. In *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) this Court said:

> "In construing the Act, we should bear in mind that it evinces no purpose to abrogate private rate contracts as such. To the contrary, by requiring contracts to be filed with the Commission, the Act expressly recognizes that rates to particular customers may be set by individual contracts. * * *
>
> "These sections [Section 4 and Section 5(a)] are simply parts of a single statutory scheme under which all rates are established initially by the natural gas companies, by contract or otherwise, and all rates are subject to being modified by the Commission upon a finding that they are unlawful. * * *
>
> "The powers of the Commission are defined by §§ 4(e) and 5(a). The basic power of the Commission is that given it by § 5(a) to set aside and modify any rate or contract which it determines, after hearing, to be 'unjust, unreasonable, unduly discriminatory, or preferential.' This is neither a 'rate-making' nor a 'rate-changing' procedure. It is simply the power to review rates and contracts made in the first instance by natural gas companies

and, if they are determined to be unlawful, to remedy them." (350 U.S. at 338, 341)[8]

Any rate or contract which the Commission after hearing does not find to be unlawful stands on its own and is not dependent upon any finding by the Commission that it is just and reasonable. The Act does not require any such affirmative finding and no court has so interpreted the Act.

D. The Commission Properly Exercised Its Discretion to Terminate Rather Than to Reopen the Section 5(a) Investigation

The Commission here determined a cost of service for Phillips. It did not attempt to use that cost of service as the basis for future rates for Phillips because it found the record was not suitable for that purpose (R. 324-325, 396-397). Petitioners do not challenge the Commission's finding that the record was unsuitable for the purpose of establishing rates for the future. Rather, they contend that the Commission should have reopened the proceedings and have received additional evidence for that purpose.

All parties thus agree that the Commission was not able or required to fix rates for the future *on the basis of this record*. The only question was whether future

[8] Petitioners emphasize the statement of the Court of Appeals in *Wisconsin* v. *Federal Power Commission*, 205 F. 2d 706, 712 (D.C. Cir. 1953) that "Phillips is a 'natural-gas company' within the meaning of the Natural Gas Act and the Commission should fix the rates at which these sales are made". Aside from the fact that this statement was made prior to this Court's decision in *Mobile*, it cannot be presumed that the Court of Appeals was directing the Commission to ignore the requirement of Section 5(a) that existing rates must *first* be found to be "unjust, unreasonable, unduly discriminatory, or preferential".

rates should be considered in some extension or reopening of this particular proceeding or this proceeding terminated and future rates considered in some new proceeding. The Commission chose the latter alternative. That decision lay well within its discretion.

In view of the Commission's findings that cost exceeded revenues and that existing rates were not unduly discriminatory or preferential (R. 325-326, 397), the only possible direction of any revision of existing rates on the basis of this record was upward. Such a course of action would necessarily require the Commission to resolve two issues which had been contested at great length before the Examiner. One was whether the principles of *Sierra* permitted the Commission on this record to set aside existing contracts because the rates were too low (R. 75-86). The other involved the form of rates which might be ordered (R. 160-196, 323-324).[9]

[9] Petitioners assume the validity of the system of rates proposed by the Examiner. His decision, however, contemplated that the Commission would fix rates not only for existing sales but also for all future sales, including rates for sales not yet made from properties not yet owned (R. 193-196). The Commission has never gone so far even with pipeline companies. Whether such a broad approach would be advisable or even permissible under this Court's decision in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) obviously would present serious issues to be decided. Section 5(a) refers only to existing rates; there is no reference to future rates for future sales. Moreover, the Examiner would have required that rates be increased to some pipelines and reduced to others, without either evidence or consideration of whether the pipelines whose purchase prices were to be increased could afford the increase or what the result would be to Phillips if they could not. At least two of the pipeline purchasers (Northern Natural Gas Co. and Panhandle Eastern Pipe Line Co.) had intervened for the sole purpose of seeing that rates to them were *not* raised above contract levels.

It was obvious to the Commission, however, that attempts to resolve these issues on the basis of the present record would constitute an exercise in futility. The fact that many rates had already been increased by virtue of contract provisions and were already the subject of separate proceedings under Section 4(e) made it unnecessary to reach either of these questions in this proceeding (R. 324-325, 397). These circumstances were in addition to the recognized fact that the test year costs were already out of date (R. 325, 396-397).

Faced with such circumstances, it clearly was within the discretion of the Commission to terminate this proceeding and to provide for beginning anew in a different proceeding. It is obvious from the language of the Commission's opinion (R. 324-325) that the Commission was well aware that, if it were to fix rates to begin in 1960 and continue into the future, it must have more current data. By terminating this proceeding the Commission did not drop or abandon its regulation of Phillips' rates as is contended by Petitioners. It merely determined that another record in another proceeding was the more appropriate place to obtain the more current data. This is a determination that can be made only by the Commission and its decision must stand unless captious. The Commission is not required to act on the basis of a particular record. *Eastern Air Lines, Inc.* v. *C.A.B.*, 294 F. 2d 235, 238 (1961), cert. denied 368 U.S. 927.

Petitioners' assertion that the Commission failed to act in this proceeding is not actually directed toward the Commission's decision not to act on the existing record. Petitioners' real complaint is that the Commission did not *reopen* this proceeding in order to proceed in the fashion which Petitioners desire. The dis-

senting opinion of Judge Fahy likewise qualifies its requirement for present decision by references to action on the present record "supplemented as may be found to be reasonably necessary" (R. 429) and "supplemented as may be needed" (R. 430). As the Commission recognized, and as Petitioners do not deny, any such reopening would require "completely new evidence" (R. 397). In substance, a reopening would constitute a completely new proceeding, whether or not designated by the same docket number. Petitioners are in reality doing no more than asking this Court to direct the Commission to institute a new rate case.[10]

The question of whether or not the proceeding should be reopened is a matter for the discretion of the Commission, not a matter of law for this Court. In *Interstate Commerce Commission* v. *Jersey City*, 322 U.S. 503, 514-515 (1944), this Court said:

> "Administrative consideration of evidence, particularly where the evidence is taken by an examiner, his report submitted to the parties, and a hearing held on their exceptions to it, always

[10] The Commission's reference to "completely new evidence" was far more prophetic than the Commission realized. One of the principal issues in this proceeding was the treatment of exploration costs. All parties then agreed that because the search for oil and gas was conducted jointly, exploration costs could be separated between oil and gas only by means of some arbitrary allocation. The allocation method selected by the Commission attributed approximately 30% of Phillips' total exploration costs to the search for gas (R. 296). Phillips has since learned that it can utilize available geological data to direct its exploratory efforts toward either oil or gas. This permits the great bulk of exploratory expenditures to be assigned directly to gas or oil without the necessity for allocation. Testimony introduced in the Permian Basin Area Rate Proceeding (Docket No. AR61-1, Transcript 160-176) shows that, on this basis, during 1959 and 1960 over 60% of Phillips' exploratory expenditures were directly chargeable to gas.

creates a gap between the time the record is closed and the time the administrative decision is promulgated. This is especially true if the issues are difficult, the evidence intricate, and the consideration of the case deliberate and careful. If upon the coming down of the order litigants might demand rehearings as a matter of law because some new circumstance has arisen, some new trend has been observed, or some new fact discovered, there would be little hope that the administrative process could ever be consummated in an order that would not be subject to reopening. It has been almost a rule of necessity that rehearings were not matters of right, but were pleas to discretion. And likewise it has been considered that the discretion to be invoked was that of the body making the order, and not that of a reviewing body.

"Only once in the history of administrative law has this Court reversed a Commission for refusing to grant a rehearing on the contention that the record was 'stale.' * * *

"The Court, however, promptly restricted that decision to its special facts. * * *."

This Court reaffirmed these statements in *United States* v. *Pierce Auto Freight Lines*, 327 U.S. 515, 535 (1946), with the further caveat: "Only a showing of the clearest abuse of discretion could sustain an exception to that rule." In *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810, 822 (D.C. Cir., 1955), cert denied 352 U.S. 829, the court said:

"Finally, we agree with the Commission that it was not required to reopen the proceedings. Petitioners sought such reopening to permit proof of increased sales volume. Evidence of such increase was offered in the effort to show that the unit cost of service would be reduced. The parties agree, however, that 1952 was a proper test

year, and the Commission made its calculations on the basis of evidence available as to that year. We find no abuse of discretion in the Commission's refusal to reopen for evidence subsequently available, especially as there is no clear indication that the evidence offered, considered with all factors involved, would likely lead to a different result."

Both *Jersey City* and *City of Detroit* involved the same kind of contentions as are made here—contentions by intervenors that subsequent increases in revenues to the regulated company required a second look by the administrative agency. The effect of the court's decision in both cases was that the validity of the Commission's action was not affected by the identity of the challenger. In *Jersey City*, this Court specifically stated that ". . . we cannot hold that the judgment of the Commission is less final merely because it has been exercised on this occasion for relief of the Company." (322 U.S. at 512)

The factors which led the Commission to decide not to reopen the proceedings make it clear also that the Commission's action here was wholly unlike that in *Minneapolis Gas Company* v. *Federal Power Commission*, 294 F. 2d 212 (D.C. Cir. 1961). There the Commission made no determination; there was nothing on which to rest its discretion. Here the Commission rendered an opinion on the record and made specific findings. It passed upon disputed issues and determined a cost of service. It specifically decided the Section 4(e) proceedings on the basis of that finding (R. 325-326, 397). It decided that such findings did not then justify further action in this Section 5(a) proceeding. In the words of the Circuit Judge who

wrote the opinions in both *Minneapolis* and the court below:

> "This is not a *Minneapolis Gas* situation, in which the Commission did nothing but simply terminated the proceedings without passing upon any of the disputed issues before it." (R. 421) (Footnote omitted)

III.

THE COMMISSION WAS JUSTIFIED IN TERMINATING THE SECTION 4(e) PROCEEDINGS

The basis of the Commission's termination of the consolidated Section 4(e) proceedings was its finding that the cost of service exceeded the revenues produced by the contract rates, including the Section 4(e) increases. The Commission found also that mere diversity of rate levels did not establish that the contract rates were unduly discriminatory or preferential (R. 325-326, 397).[11] None of the parties challenged those findings on rehearing. None of the parties even now dispute the fact that costs as found by the Commission exceeded revenues.

As indicated earlier (*supra*, pp. 20-23), Wisconsin and New York (alone among Petitioners) make a belated charge that the contract rates are discriminatory. They offer no evidence in support of that assertion, other than the mere fact of difference. But in asserting that Phillips' many different contracts result in varying prices and hence discrimination, Petitioners overlook the fact that (as stated by this

[11] The findings that existing rates were not unduly discriminatory were made separately with respect to existing rates under scrutiny in the Sec. 5(a) proceeding (R. 325) and with respect to the Section 4(e) rate increases (R. 326).

Court in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 338 (1956)):

> "'. . . by requiring contracts to be filed with the Commission, the Act expressly recognizes that rates to particular customers may be set by individual contracts. In this respect, the Act is in marked contrast to the Interstate Commerce Act, which in effect precludes private rate agreements by its requirement that the rates to all shippers be uniform, a requirement which made unnecessary any provision for filing contracts.'"

As further noted by this Court, the Act is designed to recognize the need for "individualized arrangements" (350 U.S. at 339).

With the same vehemence that Wisconsin and New York now argue that the Commission should fix rates so as to *eliminate* contract differences, the Eastern Seaboard Companies argued before the Examiner that any system of rates fixed by the Commission must *preserve* contract differences.[12] Thus, even as among Petitioners, mere differences in contract rates did not signify undue discrimination. The Commission resolved that issue by finding that the evidence did not show the contract rates to be unduly discriminatory or preferential. That finding is supported by substantial evidence and is therefore binding on this Court. Natural Gas Act, Section 19(b). Even if the differences in contract prices should constitute dis-

[12] The Examiner described the evidence of the Eastern Seaboard Companies on this point as follows: "[Eastern Seaboard witness] Caplan urged that any general rate adjustment should be accomplished with the least possible disturbance to existing market relationships, and he stressed the importance of preserving existing contract arrangements and existing contract prices to the fullest extent consistent with sound regulatory objectives." (R. 173)

crimination, "It is only when a preference or advantage accorded to one customer over another is *undue* or a difference in service as between them is *unreasonable* that Section 4(b) of the Act comes into play. 'And the courts have always recognized that Congress intended to commit to the Commission the determination, by application of an informed judgment to existing facts, of the existence of forbidden preferences, advantages and discrimination.'" *Michigan Consol. Gas Co. v. Federal Power Commission*, 203 F. 2d 895, 901 (3rd Cir. 1953).

The action which Petitioners desire this Court to take with respect to these Section 4(e) proceedings is by no means clear.[13] Petitioners do not contend they are entitled to refunds. A requirement that refunds be made would only enlarge the deficiency between cost and revenue—a clear case of confiscation. The Commission could not retroactively increase the rates over those filed by Phillips. The only action which the Commission could take is precisely the action which it did take—the dismissal of the Section 4(e) proceedings. The objective of any remand thus becomes so obscure as to become almost mysterious.

The contention is made by Petitioners that the Commission did not determine that the Section 4(e) rates were "just and reasonable". But under the circumstances such a finding would have been meaningless. The Commission found that costs exceeded revenues. To have found such rates "just and reasonable" would have required a finding that rates producing revenues less than costs are nevertheless

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[13] The Eastern Seaboard Companies do not question the dismissal of the Section 4(e) proceedings.

just and reasonable, a finding which was neither requested nor required.

The Court below found no difficulty in rejecting this contention:

> "Whether the Commission should have preceded its ultimate conclusion of no-refund with an intermediate conclusion of justness and reasonableness in the rates at issue, and whether it properly added the termination order to its decisive finding, seem to us to be immaterial queries. The important feature is that the Commission reached and decided the critical substantial issue, rationally and upon detailed findings of basic facts upon an ample record." (R. 420)

The further contention that the dismissal of the Section 4(e) proceedings permits the rates to stand during future periods without specific findings as to justness and reasonableness carries no weight. Petitioners concede that all parties agreed on a test year (Br. No. 72, p. 8), but then attempt to avoid the necessary implications of such admission by asserting that such agreed test year is not useful for future periods. Such argument disregards entirely the purpose and objective of a test year. It has been the common practice of the Commission to use the results of a test year "to develop a statement of costs and revenues for a normal year from which a just and reasonable rate may be derived for future periods." *Michigan Wisconsin Pipe Line Co.* v. *Federal Power Commission*, 263 F. 2d 553, 555 (6th Cir. 1959). In *Panhandle Eastern Pipe Line Company*, 25 FPC 787, 795 (1961), remanded on other grounds, *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 305 F. 2d 763 (D.C. Cir. 1962), the

Commission expressly used a 1954 test period with adjustments for the purpose of testing rates during the period 1954-1958 on the basis that the 1954 test year operations were representative of the later periods.

Petitioners defeat their own argument. Wisconsin and New York cite annual reports to the Commission showing Phillips' revenues during the period 1955-1961 (Br. No. 72, p. 24). This table shows that, *even assuming no increases in cost*, Phillips' revenues did not return its costs until after 1958.[14] This comparison was as readily available to the Commission as to these Petitioners. It undoubtedly was the basis for the Commission's statement: "We do not wish to prejudge those proceedings, but it would appear that on the basis of the present record that Phillips' costs probably exceed its revenues at least up through the year 1958, after which very substantial further rate increases were filed by Phillips." (R. 329)[15]

Petitioners' contentions lose all their substance when it is remembered that the Commission's ter-

[14] Contrary to the assertions of Wisconsin and New York (Br. No. 72, p. 25, Footnote 16, p. 26) the record showed that Phillips' costs were increasing. The Examiner's decision makes clear that the 1954 test year was adjusted by the addition of increases in costs known to have occurred since 1954, and that the 1954 test year *as adjusted* was comparable to the actual results of 1956. Even so, the total deficiency had increased. 24 FPC at 701-702. To compare the 1954 test year, adjusted to 1956, with 1956 costs and proclaim, as Petitioners do, that no increase had occurred since 1954 is to ignore the facts.

[15] Wisconsin and New York complain that this statement is "without record support" (Br. No. 72, p. 11). Their later use of the same data seems to indicate their position that, while Commission references must be limited, Wisconsin's and New York's are unrestricted.

mination of the consolidated Section 4(e) proceedings merely subjected Phillips' rates to other, unconsolidated, Section 4(e) proceedings (R. 3251). Wisconsin and New York say they "would have no complaint if Phillips' revenues had remained constant during the period 1955-1959" (Br. No. 72, p. 45). But all that the present decision approves is that same constant level of revenues. Revenues brought about by the "further rate increases" mentioned by the Commission are subject to pending Section 4(e) proceedings. No reversal of the present order is required to make those rate increases the subject of review by the Commission.

It is apparent that the Commission not only decided the Section 4(e) increases but that it decided them on the basis of findings that costs exceeded revenues and that existing rates were not discriminatory.[18] Those findings are supported by substantial evidence and are therefore binding on the parties and the Court. Natural Gas Act, Section 19(b). Further refinement of those findings would serve no useful purpose.

IV.

THE COMMISSION PROPERLY REFUSED TO DISALLOW CONTRACTUALLY PERMITTED INCREASES, OTHERWISE JUSTIFIED ON THE BASIS OF COST, MERELY BECAUSE THE INCREASES RESULTED FROM SO-CALLED "SPIRAL ESCALATION" CLAUSES

Three of the consolidated Section 4(e) increases considered by the Commission were filed by Phillips under contractual provisions which granted Phillips'

[18] *In R. L. Hawkins and H. L. Hawkins, Jr.*, 28 FPC 747, 748, the Commission stated: "In our Opinion No. 338, Phillips Petroleum Company, issued September 28, 1960, in which we announced our area price policy, we nevertheless made a determination of just and reasonable rates for Phillips on a cost-of-service basis because the evidence had been presented almost entirely on that basis."

an increase in rate whenever (1) the wholesale commodity index had risen by more than a specified number of points, and (2) the purchasing pipeline company had itself received a general rate increase. Upon the happening of both of these conditions, the contracts provided that Phillips' rates should be increased in proportion to the increase received by the pipeline company. The stated purpose of these provisions was protection ". . . from too great burden under the price provisions of this agreement in the event of abnormal inflation . . ." (Br. No. 73, Appendix B)[17]

These contractual provisions were treated by the Examiner and the Commission as doing no more than providing Phillips with contractual authorization to file a rate increase under the principles established in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (R. 196-208, 326-329). The issue as to the justification for these increases, as distinguished from Phillips' contractual right to utilize the filing provisions of Section 4, was decided solely on the basis of Phillips' costs (R. 327). On this basis, Phillips was found to be entitled to retain the Section 4(e) increases. With this finding there can be no complaint. Two of the increases, however, were based on rate increases being collected subject to refund by El Paso Natural Gas Company and Panhandle Eastern Pipe Line Company. Rates for these com-

[17] Two of the three contracts (including the only one involving gas destined for California) also provided for decreases in Phillips' price in the event of corresponding deflation and a reduction in the pipeline company's rates. The third had also originally provided for a decrease but, after the fact of increase in the price indices had become established, was amended to remove the downward adjustment.

panies had not yet been finally determined by the Commission. Accordingly, Phillips' increases to these two pipeline companies were given only tentative effect pending final determination of their rates. Should the full increase not be allowed to the purchasing pipeline company, Phillips will be permitted to retain only that portion of its otherwise justified increase which is proportional to the increase allowed the pipeline (the limit of the contractual consent) and will be required to refund the balance (R. 329).[18]

Contract provisions permitting price escalations at indefinite times are clearly valid and enforceable. The U. S. Court of Appeals for the Tenth Circuit has twice upheld the specific type of provision here involved as being determinative of the rate on file. *Phillips Petroleum Co.* v. *Federal Power Commission*, 227 F. 2d 470 (1955), cert. denied sub nom. *Michigan-Wisconsin Pipe Line Co.* v. *Phillips Petroleum Co.*, 350 U.S. 1005;[19] *Kerr-McGee Oil Industries, Inc.* v. *Federal Power Commission*, 260 F. 2d 602 (1958). In *Texas Gas Transmission Corporation* v. *Shell Oil*

[18] The tentative effect of the increases relates only to amount. The justification of the entire increase has been accepted by the Commission and is no longer subject to question. After specifying the procedure to be followed to determine whether the increases ultimately allowed the pipeline companies are "sufficient to permit Phillips under its contract to file the increased rates involved in Docket Nos. G-11217 and G-10883", the Commission stated: "Of course, no other matter with respect to these two dockets will remain open." (R. 329)

[19] The contract considered by the Tenth Circuit was one of the contracts now attacked by California. So far as this contract is concerned, California's present contentions constitute a collateral attack on the Tenth Circuit decision. Cf. *Michigan Consol. Gas Co.* v. *Federal Power Commission*, 203 F. 2d 895, 901 (3rd Cir. 1953).

Company, 363 U.S. 263 (1960), no question was raised as to the validity of the escalation clause in question. Indeed, in its *Cities* decision, *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 391 (1959), this Court clearly recognized that "favored-nation" clauses continue to be operative and effective. In *Warren Petroleum Corp. v. Federal Power Commission*, 282 F. 2d 312 (10th Cir. 1960), the Commission was directed to accept the filings of increases based on "favored nation" clauses.

All such contract provisions are of course subject to the provisions of Section 4 with regard to filing and review by the Commission. The fact of the contractual authorization to file for the increase does not determine the right to retain the increase. The effect of such provisions is to do no more than to provide the necessary contractual consent to the use of the filing procedures of Section 4. The Commission retains all of its powers and duties to determine whether an increase which is contractually permitted is otherwise justified.[20]

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[20] In *Mississippi Power & Light Co. v. Memphis Natural Gas Company*, 162 F. 2d 388, 390 (5th Cir. 1947), cert. denied 322 U.S. 770, the statement is made that a "'favored nation' clause became inoperative after the passage of the Natural Gas Act." This statement is in no way inconsistent with the later decisions of this Court and of the Court of Appeals for the Tenth Circuit. What was meant by the Fifth Circuit was simply that, after the passage of the Act, *all* contract provisions are inoperative to bring about a change in rates unless and until a proper filing is made with the Commission. The statement is equally applicable to contract provisions for increases in definite amounts at definite times. California does not go so far as to contend that all price increase provisions are contrary to public policy, yet one has no greater or lesser standing than another and no basis exists for distinguishing one type of provision from another.

California now contends the Commission erred in even considering whether these increases were justified by Phillips' costs (Br. No. 73, pp. 56-61). California urges that the Commission should have rejected these Section 4 filings out of hand, regardless of whether the increases were otherwise justified.[21]

The basis which California suggests for such cavalier treatment is not clearly defined. California argues that contractual provisions of this kind are invalid "on public policy grounds" (Br. No. 73, p. 60). Precisely what public policy was violated by the Commission's allowance of these increases on the basis of Phillips' costs is not specified.

Reduced to its substance, California's position constitutes an attempt to condemn valid contractual provisions on the basis of nothing but opprobrious language. Contrary to the assertions of California, there is no "spiral". The same effect which California now condemns also occurs when the Commission allows income tax payments as an item of expense —the higher revenues necessary to cover the tax payments create greater taxable income which requires still higher revenues. No suggestion has been made that this effect makes allowance of income tax expense contrary to public policy. Nor has it been thought that any "spiral" results. The final answer is determinable from the beginning by recognized mathematical processes. In similar fashion, the total increase permitted by these contractual provisions is readily determinable and but one increase is required (R. 8-10).[22]

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[21] Wisconsin also attacked these contractual provisions in the court below. It has abandoned those contentions here.

The use by California (and the Commission) of the opprobrious adjective "spiral" obscures the real purpose of that part of these contractual provisions which requires that the purchasing pipeline must itself have received a general increase before Phillips is entitled to an increase. That provision was intended to and does operate to assure the pipeline that, regardless of increases in the commodity index, it will not have to pay Phillips an increase in price unless the pipeline itself first receives a corresponding increase in rates. That part of the price increase provision was intended for the benefit of the purchaser to protect it from a squeeze between its gas purchase costs and its resale rates. The relationship to the pipeline rate which California condemns as creating a "spiral" actually serves as a restriction upon the amount of increase which Phillips may request at one time. If there are successive increases to Phillips, it is only because the contract did not permit Phillips to include the full increase to which it was entitled in its first rate increase filing.

Nothing in this record would justify the Commission in acting as California demands. The Commission expressly so found (R. 327). In *South Carolina Generating Co.* v. *Federal Power Commission*, 249 F. 2d 755, 765 (4th Cir. 1957), cert. denied 356 U.S. 912, the Commission had ordered the deletion of an escalation clause from rate schedules providing rates for the future. The court there stated:

> "We recognize that the retention or elimination of such a [an escalation] clause is a matter for the determination of the regulatory body upon findings of fact."

Whatever the powers of the Commission might be with regard to the future effect of these contract provisions, this principle is clearly applicable where, as here, the contention is that the Commission should retroactively delete such provisions. To accede to California's demand would mean outright confiscation, since the result would be to further reduce revenues which were already below cost (R. 325-326).

In an attempt to avoid the express findings of the Commission in this proceeding, California relies upon Commission statements in other proceedings—to which Phillips was not a party. One decision cited is *Michigan-Wisconsin Pipe Line Co.*, 13 FPC 326, 348-349 (1954) (Br. No. 73, p. 58). It has been judicially determined that the *Michigan-Wisconsin* proceeding is *not* binding upon Phillips. *Phillips Petroleum Company* v. *Federal Power Commission*, 227 F. 2d 470, 476 (10th Cir. 1955), cert. denied sub nom. *Michigan-Wisconsin Pipe Line Co.* v. *Phillips Petroleum Co.*, 350 U.S. 1005. Another decision cited by California is *The Pure Oil Co.*, 25 FPC 383 (1961) (Br. No. 73, p. 58). Although quoting extensively from this decision, California refrains from quoting those portions of the Commission's decision in *Pure* in which the Commission found that any proscriptive action must be limited to *future* contracts:

> "However, we are convinced that we cannot declare the escalation provisions in Pure's contracts with El Paso void or voidable, and thus in effect strike them from the contracts. There is no question but that these exceedingly material parts of the contracts were a basic part of the exchange between the parties in arriving at these agreements. Under familiar rules of law, if these material provisions are stricken, the contracts,

> which lack any provisions for the severability of parts found invalid, must also fall. This would result in legal and regulatory problems that might cause material harm to the public, harm that might well exceed the injurious effects of the escalation provisions themselves. For example, if these provisions were stricken and the contracts fell, the producer's sales might then presumably constitute *ex parte* offerings of gas and the producer could change its rates at will, unimpeded by any contractual limitations of the kind that presently exist. Thus, instead of being limited under the *Mobile* and related decisions only to increases permitted by contractual provisions, the company could file for increases whenever it happened to feel justified in doing so. Thus the uncertainty and spiraling prices resulting from the escalation clauses might well be compounded many times over." (25 FPC at 388)[22]

The drastic treatment of these contractual provisions which California demands is clearly beyond the power of the Commission. In *Willmut Gas & Oil Company* v. *Federal Power Commission*, 294 F. 2d 245, 250 (D.C. Cir. 1961) a similar contention, that the Commission abused its discretion by failing to reject certain increases without further consideration, was

[22] The Commission rejected Pure's filing, but solely on the basis that the favored nation provision had not been triggered. On the basis of this finding, the Commission's action was affirmed. *The Pure Oil Co.* v. *Federal Power Commission*, 299 F. 2d 370 (7th Cir. 1962). The court did not consider the Commission's comments with respect to escalation clauses, since the Commission had in fact taken no action on the basis of such statement. The Commission's comments as to the *ex parte* rights which would come into existence in the event its action should cause the fall of the entire contracts are consistent with similar observations of this Court in *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 155 (1960).

answered by the statement that even the broad powers granted to the Commission do not:

> ". . . authorize an order, rule or regulation which would nullify or restrict the right of a natural gas company to change the rates under which it offers to furnish service, subject only to the requirement of Section 4(d) of the Act that it notify the Commission of the changes, so that it may proceed under Section 4(e)."

The obligation of the Commission to review increases based on contractually authorized filings may not be avoided by assertions that the contract provisions violate some unstated public policy. The public policy which is controlling here is that expressed by this Court in *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.*, 358 U.S. 103, 113-114 (1958):

> "It seems plain that Congress, in so drafting the statute, was not only expressing its conviction that the public interest requires the protection of consumers from excessive prices for natural gas, but was also manifesting its concern for the legitimate interests of natural gas companies in whose financial stability the gas-consuming public has a vital stake. Business reality demands that natural gas companies should not be precluded by law from increasing the prices of their product whenever that is the economically necessary means of keeping the intake and outgo of their revenues in proper balance; otherwise procurement of the vast sums necessary for the maintenance and expansion of their systems through equity and debt financing would become most difficult, if not impossible. This concern was surely a proper one for Congress to take into account in framing its regulatory scheme for the natural gas industry, cf. Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603, 88 L Ed. 333,

> 345, 64 S. Ct. 281, and we think that it did so not only by preserving the 'integrity' of private contractual arrangements for the supply of natural gas, 350 U.S. at 344 (subject of course to any overriding authority of the Commission), but also by providing in § 4 for the earliest effectuation of contractually authorized or otherwise permissible rate changes consistent with appropriate Commission review."

Here the Commission has acted in accord with the policies which Congress so formulated. It has reviewed the increases and permitted them to stand on the basis of methods which California espouses and on findings which California does not challenge. California is entitled to nothing more.

CONCLUSION

For the reasons stated above, it is respectfully submitted that the Commission's order should be affirmed.

Respectfully submitted,

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